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## **H.R. 2676 — Internal Revenue Service Restructuring and Reform Act of 1998**

Calendar No. 341

Reported April 22, 1998, by the Senate Finance Committee, with an amendment in the nature of a substitute, by a 20-0 vote. S. Rept. 105-174. Received from the House on November 7, 1997, following a 426-4 vote.

### **NOTEWORTHY**

- The Finance Committee amendment is the product of extensive oversight hearings: three days of IRS oversight hearings last September; five days of hearings on the House-passed Restructuring bill in January and February; and four days of IRS oversight hearings this week. In addition, a field hearing was held in Oklahoma City.
- Congress' work on IRS reform follows the June 25, 1997, report by the National Commission on Restructuring the Internal Revenue Service. Legislation in both houses (S. 1096 by Senator Kerrey, and H.R. 2676) were an immediate response to the Commission report, but H.R. 2676, as reported by the Finance Committee, expands and improves upon those bills.
- In response to testimony by IRS agents and taxpayers, the Finance Committee bill greatly expands the reform measures approved by the House — particularly in the area of taxpayer protection. This expansion is both qualitative and quantitative — increasing the amount of taxpayer relief through reform efforts from \$2.6 billion over five years (as passed by the House) to \$6.5 billion, and from \$6.2 billion over 10 years to \$12.8 billion.
- The Senate substitute addresses both the earlier Commission report's findings as well as the abuses later uncovered in Senate hearings and includes: restructuring of the IRS management, personnel, and operations; a comprehensive strategy to encourage and expedite the electronic filing of tax returns; an extensive set of taxpayer protection provisions; increased congressional oversight of tax law complexity; and technical corrections for provisions included in last year's Taxpayer Relief Act (TRA, HR 2014).
- The Senate substitute is fully offset over five years with revenue raisers of \$6.55 billion, with the second five years' cost \$9.77 billion short of being offset. The House-passed version has no cost over the first five years, and \$2.85 billion over the second five years. And, so while a so-called "pay-go" point of order would lie against the bills, a managers' amendment is expect to address this matter.

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## HIGHLIGHTS

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The Finance Committee substitute contains six titles: Executive Branch Governance and Management of the IRS; Electronic Filing; Taxpayer Protection and Rights; Congressional Accountability for the IRS; Revenue Offsets and; Tax Technical Corrections.

### **Title I: Executive Branch Governance and Management of the IRS**

- The IRS Commissioner is directed to **replace the current three-tier "one size fits all" structure**, which is split along functional lines, with a structure based on serving similarly situated taxpayers (such as a structure the Commissioner has promoted that focuses on serving four taxpayer groups: individual taxpayers, small businesses, large businesses, and the tax-exempt sector, that is, employee plans, exempt organizations, and state and local governments).
- An **Oversight Board** within the Department of the Treasury is established to oversee the IRS in every aspect of its administration of the tax laws. The new board will be composed of nine members: the IRS Commissioner, Secretary of the Treasury, IRS employee union representative, and six "private-life" members to be appointed by the President with the approval of the Senate. The Oversight Board, which will have some limited 6103 authority (ability to see individual taxpayer returns), will sunset on September 30, 1998.
- The Taxpayer Advocate position was created by the Taxpayer Bill of Rights II ("TBOR 2") in 1996. The Senate amendment would replace the current problem- resolution system with a system of **local Taxpayer Advocates** (at least one in each state) who will report to the National Taxpayer Advocate and be employed by that office. The circumstances under which a Taxpayer Assistance Order could be issued are expanded to provide greater discretion to the Taxpayer Advocate, and The National Taxpayer Advocate will issue an annual report identifying areas of greatest compliance problems for taxpayers.
- The position of an independent **Treasury Inspector General for Tax Administration** is created and the current office of IRS chief inspector is eliminated. The new IG would be presidentially appointed and Senate-confirmed. The IG would produce a semiannual report on taxpayer complaints, IRS employee misconduct allegations, and the status of such complaints. The IG will also make IRS computer security a priority.
- The bill makes it **unlawful for certain Executive branch persons** (including the President and Vice President, and their employees) to conduct or terminate an audit or otherwise investigate a taxpayer.
- The IRS will gain **increased personnel flexibility** including pay flexibility, recruitment, retention, and relocation provisions. The bill also establishes new performance measures that do not rank employees based on enforcement results or collection goals. IRS employees could also be terminated for proven violations that result in the violation of

taxpayer rights including: failure to obtain the proper authorization before seizing a taxpayer's home, false statement under oath, falsifying or destroying documents, assault or battery of a taxpayer or another IRS employee, violation of the Internal Revenue Code, or concealing evidence from a congressional inquiry.

## **Title II: Electronic Filing**

- Because electronic filing holds great potential for easing taxpayers' reporting burden, reducing errors, and for greater efficiency for the IRS, the bill provides that the IRS should establish a goal of 80 percent of all tax returns being filed electronically by 2007.
- The bill extends the time for electronically filing information returns from February 28 to March 31.
- The bill develops an alternative to written signatures and a method for taxpayers to review their account electronically.

## **Title III: Taxpayer Protection and Rights**

- Reverses the burden of proof from the taxpayer to the IRS in court proceedings where the taxpayer produces credible evidence with respect to the factual issue relevant to ascertaining a taxpayer's income tax liability — if the taxpayer complies with the Internal Revenue Code, maintains proper records, and cooperates with reasonable meeting requests. Non-individual taxpayers are subject to a \$7 million net worth threshold.
- Places the burden of proof on the IRS when it uses arbitrary statistics to determine a taxpayer's income. Also, in court proceedings, the IRS may not rely on its presumption of correctness on the assessment of penalties if it fails to provide any evidence.
- Allows for the awarding of attorney's fees in a substantially expanded number of instances in which the IRS's actions are not substantially justified.
- Expands the awarding of civil damages when an IRS employee acts negligently or willfully violates bankruptcy laws.
- Overhauls "innocent spouse" relief to allow a spouse to limit liability for a joint return to the spouse's separate liability attributable to the spouse's income.
- Extends the statute of limitations for an individual during a period in which he or she is physically or mentally incapacitated.
- Eliminates the interest rate differential between the rate taxpayers must pay on underpayments and the rate the IRS must pay on refunds.
- Requires that the IRS specify to an individual the details of any penalty imposed on them and provide a detailed computation of any interest owed.

- **An extensive due process provision is included that is comprised of among other items: IRS requirement to notify taxpayer 30 days before IRS files a notice of federal lien, levy, or seizure; guarantee that taxpayer has 30 days to request a hearing by IRS Appeals and that the taxpayer can petition the Tax Court to contest the Appeal's decision.**
- **Extends attorney-client privilege to accountants and other tax practitioners.**
- **Prohibits financial status audits unless the IRS has a reasonable indication of unreported income.**
- **The IRS must implement a review process for all liens, levies, and seizures by a supervisor.**
- **Increases, and indexes for inflation, the levy exemption amounts for personal effects (to \$10,000) and books and tools (to \$5,000).**
- **Prohibits the IRS from seizing a property used as a residence for liabilities of less than \$5,000.**
- **Prohibits the waiver of the 10-year statute of limitations for the IRS to collect from taxpayers.**
- **Requires disclosures to taxpayers of (among others): explanation of joint and several liability, taxpayers' rights in IRS interviews, criteria for examination selection, the appeals and collection process, and reason for refund denial.**
- **A provision is made for up to \$3 million to be used to provide low-income taxpayer clinics.**

#### **Title IV: Congressional Accountability for the IRS**

- **Sense of Congress language that IRS should place a high priority on resolving its year 2000 computer problems.**
- **Requires the IRS to report to Congress' tax-writing committees on the sources of complexity in the tax code.**
- **Requires Congress to include a complexity analysis on tax provisions that have widespread applicability to individuals or small business taxpayers.**

#### **Title V: Revenue Provisions**

The major cost elements of the Finance-reported bill are as follows:

- **Reversing burden of proof in taxpayer's favor: \$953 million over 5 years; \$1.483 billion over the second 5 years.**

- **Innocent spouse relief:** \$1.315 billion over 5 years; \$3.842 billion over the second 5 years.
- **Elimination of penalty on individual's failure to pay during installment agreements:** \$1.315 billion over 5 years; \$3.842 billion over the second 5 years.
- **Suspension of accrual of interest and penalties if IRS fails to contact individual (with timely filed return) within 12 months of such return's receipt:** \$1.563 billion over 5 years; \$3.697 billion over the second 5 years.

The reported bill has overall costs of \$6.518 billion over 5 years, and \$12.819 billion the second 5 years.

The major revenue offset provisions of the Finance amendment are as follows:

- **Repeal Schmidt Baking with respect to vacation and severance pay:** \$3.193 billion over the first 5 years; \$860 million over the second 5 years.
- **Adjust the ability to use Foreign Tax Credits to reduce tax liability:** \$1.926 billion over the first 5 years; \$1.466 billion over the second 5 years.
- **Make ineligible for mark-to-market treatment certain trade receivables:** \$1.3 billion over the first 5 years; \$386 million over the second 5 years.

The reported bill has overall revenue offsets of \$6.552 billion over 5 years; \$3.049 billion the second 5 years, and results in raising \$34 million over 5 years and costing \$9.770 billion over the second 5 years. This compares to the House-passed version of no cost over the first five years, and a net \$2.852 billion cost over the second 5 years.

## **Title VI: Tax Technical Corrections**

- The bill contains technical corrections to the Taxpayer Relief Act (TRA) of 1997 in the following areas: TRA Title I — child care; TRA Title II — educational incentives; TRA Title III — conversions of IRAs into Roth IRAs; TRA Title III — capital gains provisions; TRA Title IV — alternative minimum tax (AMT); TRA Title V — estate and gift taxes; TRA Title VII — tax incentives for the District of Columbia; TRA Title IX — miscellaneous provisions; TRA Title X — revenue raising provisions; TRA Title XI — foreign provisions; TRA Title XII — tax simplification provisions; TRA Title XIII — estate, gift, and trust simplification; TRA Title XIV — excise tax simplification; TRA Title XV — pensions and employee benefits; TRA Title XVI — technical corrections.

Technical corrections to other tax legislation is also included.

## Amendments Offered and Accepted in Committee

- An amendment by Senator Grassley to add a representative of the organization that represents a substantial number of IRS employees to the IRS Oversight board was approved by a roll call vote of 12 yeas and 8 nays. The vote was as follows:  
*Yeas.* — Senators Grassley, D'Amato, Jeffords, Moynihan, Baucus, Rockefeller (proxy), Breaux, Conrad, Graham, Moseley-Braun, Bryan, and Kerrey.  
*Nays.* — Senators Roth, Chafee, Hatch (proxy), Murkowski, Nickles, Gramm, Lott, and Mack.
- An amendment by Senator Moynihan to include the Secretary of the Treasury on the IRS Oversight Board was approved by a roll call vote of 12 yeas and 8 nays. The vote was as follows:  
*Yeas.* — Senators Chafee, D'Amato, Jeffords, Moynihan, Baucus, Rockefeller (proxy), Breaux, Conrad, Graham, Moseley-Braun, Bryan, and Kerrey.  
*Nays.* — Senators Roth, Grassley, Hatch (proxy), Murkowski, Nickles, Gramm, Lott, and Mack.
- An amendment by Senator Grassley to authorize State tax agencies to participate in the Federal program of refund offsets was approved by a roll call vote of 14 yeas and 6 nays. The vote was as follows:  
*Yeas.* — Senators Chafee (proxy), Grassley, Hatch, D'Amato (proxy), Jeffords (proxy), Moynihan, Baucus, Rockefeller (proxy), Breaux, Conrad, Graham, Moseley-Braun, Bryan, and Kerrey.  
*Nays.* — Senators Roth, Murkowski, Nickles, Gramm, Lott (proxy), and Mack.

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## ADMINISTRATION POSITION

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The Administration at the time this Notice was being written had not yet released an official position on the Finance Committee's reported bill. However, during the week of April 14, it was reported that the Treasury Department's associate tax legislative counsel "presented negative views of key taxpayer rights provisions in the bill — including provisions to limit interest and penalties on delinquent taxes and to shift the burden of proof from the taxpayer to the IRS in disputes over tax obligations," according to *Congress Daily AM* [April 21, 1998]. The Administration has announced support for the less stringent reform legislation passed last year by the House.

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## COST

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The Senate substitute, as reported, is fully offset over five years with revenue raisers of \$6.55 billion, with the second five years' cost \$9.77 billion short of being offset. This compares to the House-passed version: no cost over the first five years; \$2.85 billion over the second five

years. As a result, a so-called "pay-go" point of order would lie against the bills under the congressional pay-go points of order provision from Sec. 202 of H.Con.Res.67 (FY96 Budget Resolution) passed on June 29, 1995 (however, it is understood that a managers' amendment will address this for the bill before the Senate).

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## POSSIBLE AMENDMENTS

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In addition to an anticipated manager's amendment, any of the amendments offered in committee could be revisited on the Senate floor — with amendments that failed (see below) being re-offered, and also possibly some amendments to strike language that was accepted in committee (see listing, on p. 6, of amendments offered and accepted). The following five amendments were offered in committee and defeated.

**D'Amato.** Offered in committee amendment to guarantee coverage of inpatient hospital care for breast cancer; defeated by a roll call vote of 8 yeas and 10 nays. (The Chairman ruled this amendment non-germane.)

**Kerrey.** Offered in committee amendment to substitute the language of the House-passed bill for the Chairman's mark; defeated by a roll call vote of 8 yeas and 12 nays.

**Conrad.** Offered in committee amendment to strike the burden-of-proof provision of the Chairman's mark; defeated by a roll call vote of 5 yeas and 15 nays.

**Graham/Moynihan.** Offered in committee amendment to implement a tobacco tax increase of 5 cents per cigarette pack and accelerate a 15-cents-per-pack increase, and also to reduce the period for collecting taxes from 10 to 6 years, increase the refund claim period from 3 to 6 years, and to extend such periods to all taxes; defeated on a roll call vote of 8 yeas and 12 nays.

**Rockefeller.** Offered in committee amendment to modify the privilege of practitioner-client confidentiality provision in the Chairman's mark; defeated by a roll call vote of 3 yeas and 17 nays.

In addition, the following amendments have been mentioned:

**Faircloth.** To remove union representative from the IRS oversight board.

**Nickles.** To alter the conflict of interest provisions for the union representative to the oversight board.

**Kerrey.** Requirement that two coordinated hearings be held annually before a select group of members from the relevant oversight committees of both the Senate and House.

**Bond.** Establishes a full-time IRS Board of Governors.

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